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June 10, 2004

TO: Supervisor Don Knabe, Chairman
Supervisor Gloria Molina
Supervisor Yvonne B. Burke
Supervisor Zev Yaroslavsky
Supervisor Michael D. Antonovich

FROM: J. Tyler McCauley
Auditor-Controller 

SUBJECT: **LOS ANGELES HOMELESS SERVICES AUTHORITY - FINANCIAL
REVIEW**

We have completed a financial review of the Los Angeles Homeless Services Authority (LAHSA or Agency) for the period of January 1, 2003 through November 30, 2003. Our review focused on evaluating LAHSA's internal controls and compliance with established fiscal policies and procedures in key areas such as revenue, cash, expenditures, and payroll. We also reviewed LAHSA's budgetary performance, and its contracting and claiming operations. In addition, we reviewed the minutes from several Operations Committee and LAHSA Commission meetings for discussions involving LAHSA's financial operations.

Background

On February 13, 2001, both your Board and the Los Angeles City Council approved the Amended and Restated Joint Powers Agreement (JPA) between the County and City of Los Angeles that granted LAHSA fiscal autonomy from the County. Per Section 8 of the JPA, the Auditor-Controller is required to conduct semi-annual reviews of LAHSA's accounts and records during the second and third years of the agreement. This report covers the results of both our second and third semi-annual reviews.

LAHSA's budgeted appropriations for Fiscal Year (FY) 2003-04 are \$55.1 million, and the Agency employs approximately 43 permanent employees.

Review Summary

We found that LAHSA has generally operated within its budget and that it was performing its basic accounting procedures in a satisfactory manner. In addition, our review of minutes from the Operations Committee and LAHSA Commission meetings did not disclose any issues that negatively affect LAHSA's financial operations.

We did note that LAHSA needs to make changes to the current cash handling process to ensure cash is adequately safeguarded and that all revenue receipts are accounted for and deposited. We also concluded that LAHSA needs to improve its contract monitoring operations. For example, during FY 2002-03, only four (2%) of LAHSA's approximately 200 contracts received an on-site fiscal monitoring review. To ensure contractors are complying with the terms of their contracts, LAHSA needs to conduct on-site fiscal reviews of its contracts at least once every other year. To meet this goal, LAHSA needs to evaluate the cost effectiveness of contracting out all or a portion of its fiscal monitoring efforts. In addition, LAHSA should document its contractor monitoring plan, including the frequency and type (i.e., on-site versus desk) of monitoring and prioritize agencies to be reviewed. The procedures should also include steps for conducting, documenting, reporting, and following up on audit results.

Review of Report

We thank LAHSA management and staff for their cooperation and assistance during our review. We discussed the results of our review with Agency management. LAHSA's initial response (attached) indicates agreement with our findings and recommendations. LAHSA will provide the Board with a detailed corrective action plan and timeline for implementation of the recommendations within 30 days, with a copy to our office. In addition, LAHSA will provide the Board with quarterly status reports regarding the implementation status of the recommendations until all recommendations have been implemented.

If you have any questions, please contact me or have your staff contact DeWitt Roberts at (626) 293-1101.

JTM:DR:TK

c: David E. Janssen, Chief Administrative Officer
Los Angeles Homeless Services Authority
Mitchell Netburn, Executive Director
Sandra Roberts, Chief Financial Officer
Violet Varona-Lukens, Executive Officer, Board of Supervisors
Public Information Office
Audit Committee

Los Angeles Homeless Services Authority

Financial Review

June 2004

Prepared by:

Department of Auditor-Controller

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Los Angeles Homeless Services Authority
Financial Review

Comments and Recommendations

Background

The Los Angeles Homeless Services Authority (LAHSA) provides funding to a network of local, non-profit agencies to support, create and sustain solutions to homelessness. A wide-range of services is provided, including: domestic violence, mental illness, substance abuse, job training, housing, food, health, and transportation. For Fiscal Year (FY) 2002-03, LAHSA received approximately \$46 million from City, County and federal sources to carry out its mission. LAHSA employs approximately 43 permanent employees.

Budgetary Control

In examining LAHSA's adherence to its budget, we compared the Agency's actual financial results to its adjusted budget for FY 2002-03. The results are summarized below:

Budget to Actual Financial Results
Fiscal Year 2002-03

	<i>Budget</i>	<i>Actual</i>	<i>Over or (Under)</i>
Expenditures	\$46,080,146	\$34,480,344	\$(11,599,802)
Revenues	\$46,080,146	\$34,740,529	\$(11,339,617)
Difference	-	\$260,185	\$260,185

LAHSA generally operated within its budget. However, we noted the Agency under-realized revenues by \$11.3 million during FY 2002-03, and actual expenditures were under budget by a like amount. These variances are primarily attributable to LAHSA's revenue estimation methodology. For example, LAHSA's CFO estimates contract revenues by dividing the total dollar value of its service provider contracts by three (i.e., most contracts have a three year term). However, this methodology does not consider whether contract expenditures are spent evenly over the three-year period. In addition, we noted that several new programs started later in the FY than LAHSA originally anticipated. As a result, program expenditures were not incurred and the resulting revenues were not received.

Budgets provide the most benefit when they represent the best estimate of actual expected results. LAHSA should account for and budget revenues and expenditures based upon the anticipated expenditures to be incurred during the budget year. The variances noted above indicate a need for LAHSA to re-evaluate its budgeting methodology.

Recommendation

1. **LAHSA management re-evaluate its budgeting methodology.**

Cash

LAHSA contracts with approximately 100 service providers to provide a variety of services related to homelessness. To pay for these services, LAHSA submits claims for reimbursement to its funding sources and, when funding is received, forwards the appropriate amounts to the service providers. LAHSA receives funds primarily in the form of checks through the mail. On occasion, LAHSA receives donated cash and/or checks through the mail.

As detailed throughout this section, LAHSA management needs to make changes to the current cash handling process to ensure cash is adequately safeguarded and that all revenue receipts are accounted for and deposited. In addition, we noted instances in which LAHSA's fiscal policy manual did not contain the necessary controls. We provided LAHSA management with the related controls from the Los Angeles County Fiscal Manual (CFM) to use in revising their fiscal manual. LAHSA management should incorporate cash handling and other CFM control policies noted throughout this report into its own fiscal policy manual.

Recommendation

2. **LAHSA management incorporate cash handling and other CFM control policies noted throughout this report into its own fiscal policy manual.**

Separation of Duties

CFM section 1.1.3 requires that cash handling duties must be separated to ensure that no one individual controls all key aspects (e.g., receiving, depositing, disbursing, reconciling and recording) of a cash transaction. This is necessary to reduce the likelihood of losses occurring and going undetected. In addition, CFM section 4.4.9 states that checks must be mailed by the check signer and not returned to the employee who prepared the check.

LAHSA maintains two checking accounts, one for its General Operations and the other for its Emergency Assistance to Prevent Eviction & Moving Assistance Program (Rent to Prevent). We noted that LAHSA's Chief Financial Officer (CFO) signs checks, reconciles the General Operations account, approves the Rent to Prevent bank reconciliation, and prepares deposits in her staff's absence. The CFO also has access to blank check stock. Another individual both reconciles and prepares the deposit for the Rent to Prevent account. We also noted that staff that prepare checks receive them back after management has signed them. Some of these weaknesses were addressed in our prior audit report, dated June 4, 2003.

LAHSA management should review cash controls to ensure cash handling duties are adequately separated.

Recommendation

3. LAHSA management review cash controls to ensure cash handling duties are adequately separated.

Safeguarding Collections

Chapter 1 of the CFM requires departments to establish controls over all phases of cash handling operations, such as limiting access to cash (defined as both cash and checks) placing daily receipts in a secured location until ready for deposit, and depositing collections of \$500 or more daily. We noted that LAHSA can improve procedures to better safeguard collections prior to deposit, as follows:

- LAHSA does not assign two staff to open the mail and record receipts. We noted that LAHSA received approximately \$20.5 million in mail remittances during calendar year 2003. Accordingly, LAHSA should consider assigning two employees to open the mail and record receipts as required by the CFM.
- The individual responsible for opening the mail does not prepare a separate list of remittances for use by Fiscal staff in reconciling daily collections to deposits. Daily deposits should be reconciled to the mail remittance log to ensure all collections are deposited.
- LAHSA stores deposits and checks awaiting pick up by service provider staff in an unlocked filing cabinet with easy access by fiscal and program accounting staff.
- LAHSA does not deposit funds daily, or at a minimum, when collections exceed \$500 or more. For example, five (36%) of 14 deposits reviewed contained checks that had been received from two to 11 days prior to deposit. The check amounts ranged from approximately \$3,500 to \$578,000.
- LAHSA does not have adequate controls in place to account for cash or other valuables transferred from one employee to another. For example, LAHSA stores deposits awaiting pick up by LAHSA's messenger in an unlocked filing cabinet. In addition, mail remittances are not counted by two individuals prior to forwarding the remittances to finance for deposit. We also noted that staff who receive parking validation books for distribution do not sign for receipt of their books. These transfers reduce accountability and increase the risk of loss. When transfers are deemed necessary, two people should always count the cash and checks together, and sign and date a "record of money received" indicating the amount to be transferred.

Recommendations**LAHSA management:**

- 4. Consider assigning two employees to open the mail and record receipts.**
- 5. Require staff to prepare a mail remittance log for use by Finance staff in reconciling daily deposits to collections.**
- 6. Ensure funds awaiting deposit or pick-up are secured in a locked drawer or safe with access limited.**
- 7. Ensure all collections are deposited within one day of receipt, or at a minimum, when collections reach \$500 or more.**
- 8. When transfers of cash or other valuables are necessary, require two people to count the cash, checks or other valuables together, and sign and date a transfer advice ticket indicating the amount to be transferred.**

Bank Reconciliations

CFM Section 1.2.3 states that the person reconciling the account(s) must prepare the reconciliation in a timely manner. Bank statement reconciling items must be reviewed and researched immediately and all reconciling items should be resolved within the next bank statement period. If the reconciling item cannot be resolved within the next bank statement period, it should be monitored until resolved.

As previously noted, LAHSA has two checking accounts, a General Operations and a Rent to Prevent account. We reviewed the bank reconciliations for the period January through November 2003 and noted the following:

- Bank reconciliations for the General Operations account are not completed or reviewed in a timely manner. For example, staff did not complete nor did a supervisor review the July through October 2003 bank reconciliations until December 2003. In addition, the March through June 2003 reconciliations showed no evidence of supervisory review.
- The CFO carries some items (i.e., bank fees, unknown items) forward as reconciling items until she has time to investigate, resolve and/or appropriately record the items in the accounting records. For example, the September 2003 bank reconciliation contained approximately \$6,800 in reconciling items from transactions occurring between May and August 2003.

LAHSA management should ensure bank reconciliations are completed and reviewed in a timely manner. In addition, management should ensure that reconciling items are investigated and resolved timely.

Recommendations

LAHSA management:

- 9. Ensure bank reconciliations are completed and reviewed in a timely manner.**
- 10. Ensure reconciling items are investigated, resolved and recorded in the accounting records timely.**

Disbursements

We reviewed 60 disbursements for the period January through November 2003 to ensure that adequate supporting documentation was available, they contained appropriate approvals, they were paid timely, and that original receipts were marked "paid" to prevent reuse. We noted the disbursements were properly authorized, supported and paid within appropriate timeframes. However, 25 (42%) of 60 documents were not marked "paid" to prevent reuse.

LAHSA management ensure supporting documents are properly marked "paid" to prevent reuse.

Recommendation

- 11. LAHSA management ensure supporting documents are properly marked "paid" to prevent reuse.**

Payroll

Payroll Controls

LAHSA's fiscal policy manual section 9.2.2 states that time cards should not be returned to employees after the employees' supervisors have approved them. However, we noted that LAHSA staff who prepare the payroll receive their timecards back after supervisory approval. In addition, CFM Section 3.1.11 states that payroll sections should never be directly involved with receiving, distributing, storing, or otherwise handling warrants and direct deposit notices (DDN). We observed that LAHSA payroll staff receive payroll warrants and DDN from the outside payroll contractor prior to distribution.

To strengthen controls over payroll, LAHSA management should ensure time cards are not returned to employees after their supervisors have approved them. In addition, payroll staff should not be involved in the handling of payroll warrants and DDN.

Recommendations

LAHSA management:

- 12. Ensure time cards are not returned to employees after the employees' supervisors have approved them.**
- 13. Ensure payroll staff are not involved in the handling of payroll warrants and DDN.**

Contract Monitoring

During FY 2002-03, LAHSA had approximately 200 contracts with 94 service providers. LAHSA staff conduct fiscal monitoring of these contracts to ensure expenditures do not exceed the contract's funding allocation and that program expenditures are appropriate and adequately supported. LAHSA's funding sources require LAHSA to conduct fiscal monitoring. However, the funding sources have not generally specified the type or frequency of monitoring required.

LAHSA states that its goal has been to conduct an annual on-site fiscal review of each contract. However, effective December 2003, LAHSA implemented the Department of Housing and Urban Development's (HUD) new monitoring requirement for LAHSA's Supportive Housing Program (SHP) contractors. Specifically, HUD is requiring LAHSA to conduct 100% review (either on or off-site) of expenditure documentation for its SHP contract expenditures during the first year of the contract's term. However, due to the volume of contracts and the fact that most contracts are for a one-year term, limited staffing, and the new HUD requirement, LAHSA no longer believes it is possible to conduct annual on-site fiscal reviews for all contracts.

We conducted a review of LAHSA's fiscal monitoring efforts during FY 2002-03 and noted that four (2%) of the approximately 200 contracts received an on-site fiscal monitoring review. However, we noted that in most instances, LAHSA conducted "desk" reviews, which require service provider staff to provide LAHSA staff with copies of expenditure support documents (e.g., invoices, receipts, etc.) for review. For the approximately 200 contracts, we noted the following:

- LAHSA staff were unable to tell us how many desk reviews they completed for the 132 SHP contracts.
- LAHSA completed desk reviews on 24 (77%) of its 31 Emergency Shelter Grant (ESG) contracts.

- LAHSA completed desk reviews on all 35 (100%) of its Community Development Block Grant (CDBG) contracts.

We observed that LAHSA does not have written procedures for determining the frequency and type (e.g., on-site versus desk, etc.) of fiscal monitoring to perform, or for prioritizing which agencies to review first. Further, there are no written procedures detailing how to conduct the review, how to report the results, and/or for following up on the implementation of findings previously reported.

To ensure contractors are complying with the terms of their contracts, LAHSA needs to conduct on-site fiscal reviews of its contracts at least once every other year. To meet this goal, LAHSA should (1) re-negotiate with HUD the need to conduct 100% expenditure documentation reviews for its SHP contracts, and (2) evaluate the cost effectiveness of contracting out all or a portion of its fiscal monitoring efforts. In addition, LAHSA should document its contractor monitoring plan, including the frequency and type (e.g., on-site versus desk, etc.) of monitoring and the prioritization of agencies to be reviewed. The procedures should also include steps for conducting, documenting, reporting, and following up on audit results. In addition, LAHSA management needs to ensure that staff document and maintain the results of their monitoring efforts.

Recommendations

LAHSA management:

- 14. Ensure contractors receive a fiscal on-site monitoring visit at least once every other year.**
- 15. Re-negotiate with HUD the need to conduct 100% expenditure documentation reviews for its SHP contracts.**
- 16. Evaluate the cost effectiveness of contracting out all or a portion of its fiscal monitoring efforts.**
- 17. Document its fiscal monitoring plan, including the frequency and type (i.e., on-site versus desk) of monitoring and the prioritization of agencies to be reviewed. The procedures should also include steps for conducting, documenting, reporting and following up on audit results.**
- 18. Ensure staff document and maintain the results of their monitoring efforts.**



Mitchell Netburn
Executive Director

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June 8, 2004

J. Tyler McCauley, Auditor Controller
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Kenneth Hahn Hall of Administration
500 West Temple Street
Los Angeles, CA 90012

Dear Mr. McCauley,

The Los Angeles Homeless Services Authority (LAHSA) is in receipt of the financial review report prepared by the Audit Division of the Los Angeles County Auditor-Controller Department. Our office has reviewed the report and is in agreement with the findings and recommendations made by your office.

Of the 18 findings noted in the report, LAHSA has implemented internal control procedures for the correction of findings 1-13. We will detail the specific procedural change in the corrective action plan that is due to the Board of Supervisors within 30 days of your letter. Findings 14-18 relate to our fiscal monitoring procedures. Correcting these findings will require negotiating with the Department of Housing and Urban Development (HUD). Our Chief Financial Officer has developed a Risk Analysis Matrix that will identify the agencies that are most at risk for non-compliance with contractual and federal regulation. LAHSA is in the process of negotiating the use of this methodology in lieu of reviewing 100% expenditure documentation for the Supportive Housing Program contracts, which comprise the majority of our sub-contracts.

As directed by your report, LAHSA will provide the Board of Supervisors with quarterly reports on the status of the implementation of all recommendations. As previously indicated, we have modified internal control procedures for findings 1-13. As a result, our quarterly report will focus on implementation procedures for findings 14-18.

We greatly appreciate the assistance of the Audit Division in performing the review and identifying areas in which our internal controls and monitoring procedures can be improved. Your audit staff conducted the review in a professional and diligent manner and was helpful in providing guidance to our Chief Financial Officer for proposed corrective actions for findings 1-13.

If you have any questions regarding this response, please call me at (213) 683-3328 or your staff may contact Sandra Roberts, LAHSA's Chief Financial Officer, at (213) 683-3341.

Sincerely,

Mitchell Netburn
Executive Director

c: Sandra Roberts, Chief Financial Officer